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SUBJECT: MOROCCO TRADES SUBSIDIES FOR STABILITY IN THE FACE OF PRICE INCREASES

REF: A. 07 RABAT 1525 B. CASABLANCA 00035

(U) This cable was coordinated with Embassy Rabat.  
This cable being transmitted from Rabat for Casablanca.

¶1. (SBU) Summary: Like other countries in the region, Morocco has been buffeted by rapidly escalating international commodity prices. Internal factors such as the 2007 drought have compounded the problem. While official indexes do not yet reflect these price pressures, the exploding budget of the Moroccan government's Compensation Fund and increasing public angst about price increases for basic foodstuffs highlight the impact of rising costs. While the government spoke earlier this year of the need to reform the subsidy system, it has pledged publicly not to increase the price of subsidized goods. The brief unrest last year over bread prices revived memories of past food riots, inducing the government to continue to pay subsidies for the sake of political stability as long as it can manage it. End Summary.

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INTERNAL AND EXTERNAL FACTORS RAISE PRICES  
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¶2. (SBU) Rising prices in Morocco are due in large part to increases in international commodity prices. The Compensation Fund, the government entity that oversees subsidies, shields consumers from increases in the cost of bread, sugar and butane, but not other essential staples such as cooking oil, pasta and butter. Analysts point out that Morocco, like the rest of the world, is also starting to experience the end of the deflationary benefit it received from cheap Asian imports. Khalid Belyazid, Director of Groupe Eco-Medias, publisher of the daily L'Economiste, notes that mass production in China has driven the cost of industrial products down for years, slowing inflation. Now, however, newfound wealth in China and India has put previously unattainable goods within reach of these countries' consumers, raising demand and, in turn, prices. "Morocco is a small player," he says, "but it is suffering the consequences."

¶3. (SBU) While external factors are the main cause of Morocco's price increases, internal factors also play a role. Severe drought in 2007 caused the country's cereal harvest to be 66 percent below average, necessitating a substantial increase in costly imports. Jawad Kerdoudi, an economist who is President of the Moroccan Institute for International Relations, argues the resulting "imported inflation" put upward pressure on local salaries, which then put pressure on prices. Indeed, unions are calling for the government to raise the guaranteed minimum wage (SMIG), a measure that is under discussion. Many Moroccans also allege that retailers are taking advantage of the inflationary environment to engage in price-gouging, and complain of the government's failure to implement legislation to protect

consumers, an oversight the government has moved to correct in recent weeks.

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HOW BAD IS THE PROBLEM?  
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¶4. (SBU) Moroccans who feel their purchasing power has been badly eroded point to dramatic increases in the prices of such staples as cooking oil, up 65 percent in recent months, couscous, which has risen 30 percent, and other basic products. Aziz Benmaazouz, Director General of the micro-credit organization Fondation Zakoura, noted in a recent meeting that clients receiving loans have had more difficulty repaying them since prices began to rise. Furthermore, the foundation's employees, who earn modest salaries, are also challenged to make ends meet. We hear anecdotally that even employers in the financial and other sectors who offer higher wages are starting to feel pressure from their employees for wage increases.

¶5. (SBU) Despite dramatic price increases, however, Morocco's inflation indexes continue to show a benign inflationary environment. Overall inflation, according to the "index of the cost of living" fell from 3.3 percent in 2006 to two percent in 2007. Critics allege that the index, based on a 1989 market basket, is outdated and fails to track current consumption patterns. They also highlight its urban bias. Price increases for basic goods most dramatically impact the 40 percent of Moroccans living in the countryside, who spend a higher proportion of their incomes on them, researcher Hicham Benjamaa told us. Not surprisingly, most protests against rising prices have started in rural towns.

¶6. (SBU) The compensation system itself also holds down official

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inflation rates. Nizar Baraka, Morocco's Minister-Delegate for Economic and General Affairs, recently argued that without the Compensation Fund's intervention, inflation would have exceeded 5.4 percent over the last year. Certainly, the price pressure is evident in the budget allocated to the Fund, which increased five-fold from 4 billion MAD in 2002 to 20 billion MAD this year. Observers warn that even this sum may prove insufficient, as it is based on the expectation of a world oil price of 75 USD per barrel. With each dollar-a-barrel increase above that level costing the fund 450 million MAD, there are fears the initial allocation will run out by mid-year, forcing either supplemental allocations or a return to the Fund's practice of delaying payments to suppliers.

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GOVERNMENT RETHINKS ITS APPROACH  
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¶7. (U) With social peace in mind, the GOM is carefully considering how to respond to rising prices. The increase in the price of bread from 15 to 19 cents in September 2007 resulted in rapidly growing protest. After the breakout of an isolated, but potentially seminal, riot in the eastern market town of Sefrou, the government quickly annulled the increase and granted higher flour subsidies, returning bread prices to normal (REF A). According to the Moroccan Press Agency, 34 people were jailed in late February for participating in the Sefrou riots. (Note: The King recently visited Sefrou and brought extensive development commitments). Recent increases are again spurring trouble and local NGOs are threatening to protest.

¶8. (SBU) While Baraka has spoken publicly and privately of the need to reform the Compensation Fund, he has downplayed such suggestions in recent public comments. Instead, he and other government officials have stressed that the government will continue to insulate consumers from increasing world prices for goods that are subsidized in Morocco.

¶9. (SBU) Outside the government, economists and analysts are debating how the compensation system might be changed. Currently, subsidies benefit all Moroccans, regardless of financial status. As Belyazid noted and several colleagues confirmed, a moderate increase in food prices is tolerable for most people, who barely notice the

difference. Still, the GOM "continues to help Moroccans to eat." In Belyazid's words, "It's ok to subsidize flour for bread, but not for a croissant." Recognizing that the government cannot continue to finance large, general subsidies, some Moroccan analysts are talking about directing resources to the segment of the population that truly needs them.

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FUTURE UNCERTAIN  
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¶10. (SBU) How critical the problem of inflation may become remains unclear. Central Bank governor Jouahri warned last week that while overall inflation rates remain under control, underlying inflationary pressures could spur an inflationary spike this year. IMRI's Kerdoudi estimates that Morocco's inflation rate could jump to three or four percent this year. Zakoura's Benmaazouz shared this gloomy outlook, saying he is "not sure things will improve."

¶11. (SBU) Comment: Many Moroccans view their country as a welfare state that intervenes to shield consumers from significant price increases. The Moroccan government does not dispel this perception, and views its protection as essential to staving off the labor unrest or even riots that historically have occurred when basic commodity prices have risen steeply. Faced with public angst over inflation and given rising revenues and the country's low level of national debt, the GOM will continue to trade subsidies for political stability, putting off hard questions about reforming the Compensation Fund. End Comment.

Riley